Veil piercing and abuse of the corporate form

van der Elst, Christoph; Bruloot, Diederik ; De Meulemeester, Louis

Published in:
Abuse of companies

Publication date:
2019

Document Version
Publisher's PDF, also known as Version of record

Abuse of Companies

Edited by

Hanne S. Birkmose
Mette Neville
Karsten Engsig Sørensen

Wolters Kluwer

Published by:
Kluwer Law International B.V.
PO Box 316
2400 AH Alphen aan den Rijn
The Netherlands
E-mail: international-sales@wolterskluwer.com
Website: lrus.wolterskluwer.com

Sold and distributed in North, Central and South America by:
Wolters Kluwer Legal & Regulatory U.S.
7201 McKinney Circle
Frederick, MD 21704
United States of America
Email: customer.service@wolterskluwer.com

Sold and distributed in all other countries by:
Air Business Subscriptions
Rockwood House
Haywards Heath
West Sussex
RH16 3DH
United Kingdom
Email: international-customerservice@wolterskluwer.com

Printed on acid-free paper.

ISBN 978-94-035-0892-4

e-Book: ISBN 978-94-035-0895-5
web-PDF: ISBN 978-94-035-0902-0

Printed in the United Kingdom.

Editors

Hanne S. Birkmose is a Professor at the Department of Law, Aarhus University, Denmark. Her research areas include Company Law – in particular International Company Law and EU Company Law – and Corporate Governance, and she has written several national and international articles within these areas. She is also the author of books on UCITS and Alternative Investment Funds in Denmark. Recently, she has mainly worked with shareholder activism and the role of institutional shareholders. In 2014, she received a three-year research grant from the Danish Independent Research Council for a project on Shareholders' Duties. She is a member of the ECGI (European Corporate Governance Institute, Brussels), the Nordic Company Law Network, and the Nordic Corporate Governance Network.

Mette Neville is a Professor at the Department of Law, Aarhus University, Denmark and a director of the Centre for Small and Medium-sized Enterprises http://law.au.dk/en/research/research-activities/centre-for-small-and-medium-sized-enterprises/, which is an interdisciplinary research centre that focuses on growth and development in SMEs, including the value creation of the board. She leads several major research projects in collaboration with the SMEs, such as 'The SME board as a digital catalyst': http://law.au.dk/digital-katalysator/ 'Vidensforum.dk', 'Growth management for the future': http://bss.au.dk/vaekstledelse-for-fremtiden/. She is the head of education for Board education with a focus on SMEs, and Education for the Chairman of the Board (both at Aarhus BSS) and she has extensive board experience. She is a member of several Councils and Committees, for example the SME:Board (appointed by the Minister for Industry, Business and Financial Affairs), Chairman of the Disciplinary Committee at OMX Commodities, Norway (financial energy market for Norway, Denmark, Sweden and Finland, and she is a member of the expert panel of the Financial Supervisory Authority's Board of Directors.

Karsten Engsig Sørensen is a Professor at the Department of Law, Aarhus University, Denmark. He holds a Danish law degree, a PhD (on EU Company Law), and a Danish Dr. Jur. (on joint ventures). Furthermore, he holds an LLM from the University of Exeter. His research is mainly focused on EU Law and Company Law, and within these areas he has published several books and articles in both Danish and English. Additionally, he has been the editor of several books on Company Law, EU Law, and WTO Law appearing on, *inter alia*, Kluwer Law International and Cambridge University Press. He is a one of the two editors of the SSRN e-journal on Nordic and European Company Law, and a member of the Nordic Network for Company Law.

Contributors

Anna Rosa Adiutori is a full Professor in Business Law at the Department of Law and Economics of Productive Activities Faculty of Economics at the Sapienza University of Rome. Her research areas include Company Law and Corporate Governance, and she has written several articles within these areas. She is also the author of three books on Company Law and Subcontracting. She is a member of the OCC, Orizzonti di Diritto Commerciale, which is the Italian association of Business Law Professors.

Helen Anderson is a Professor and teaches and researches Corporations Law and Insolvency Law at Melbourne Law School, University of Melbourne. Her research interests lie in the fair treatment of vulnerable parties. Her work has looked at creditors in corporate insolvency, and more recently, it has focused on improving the recovery rights of employees in corporate insolvency and investigating ways to regulate fraudulent phoenix activity. She has been awarded two Australian Research Council grants to undertake this research.

Alessio Bartolacelli is an Associate Professor of Business Law at the Department of Law, University of Macerata, Italy. He graduated in Law from the University of Modena and Reggio Emilia (2004), and got his PhD in Business Law from the University of Brescia (2008). Before joining the University of Macerata (2015), he was a Research Fellow at the University of Trento (2008-2009) and at the University of Bologna (2015), and a Marie Curie & TRENTINO Fellow at the University of Trento (2011-2014, with a grant awarded by the European Commission and the Autonomous Provence of Trento). His main research interests are in the field of Italian, European and Comparative Company Law, with a special focus on SMEs. He has published several works on Company- and Enterprise-related topics, mainly in Italian, English, and Portuguese. In particular, he is the author of two books on Hybrid securities in public companies, and on the EEIG. He is a member of the Editorial Staff of the Journals *Giurisprudenza Commerciale* and *Orizzonti del Diritto Commerciale*.

Diederik Bruloot is a Professor of business law at the Law School of Ghent University (Belgium). His current research focuses on the legal aspects of corporate finance. Over the last years, he published on a broad range of topics in the area of company law, insolvency law and financial regulation. He obtained his PhD from Ghent University in 2012 with a thesis regarding creditor protection in European company law. He is a member of Ghent University's Financial Law Institute and of the Belgian National Centre for Company Law. Furthermore, he is member of the editorial boards of the leading Belgian journals on company law (TRV-RPS) and insolvency law (TIBR).

Blanaid Clarke holds the McCann FitzGerald Chair in Corporate Law at Trinity College Dublin. Her research interests include corporate law, corporate governance, financial services law and takeover law, and she has published extensively in these areas. She is the Irish representative on the OECD Corporate Governance Committee, and she is a member of the European Securities and Markets Authority's Takeover Bids Network and its Securities and Markets Stakeholder Group. She also serves as a Vice President of the Academic Board of the European Banking Institute in Frankfurt. She works with the Irish Takeover Panel and is a member of the Irish Banking Culture Board. Previously, she was also a member of: the Irish Central Bank Commission (2010-2018); the European Commission's Informal Expert Group on Company Law (2014-2018); and the Reflection Group on the Future of EU Company Law (2010-2011).

Louis De Meulemeester is a PhD researcher at the Financial Law Institute of Ghent University. His PhD research focuses on the protection of creditors in groups of companies. More broadly, his areas of interest include all matters relating to Company and Insolvency Law.

Janet Dine is a Professor of International Economic Development Law at Queen Mary University of London, and from 2005-2008, she was a Director of the Centre for Commercial Law Studies. She is an Honorary Professor at Dundee. Professor Janet Dine is a barrister. In 1978, she became a lecturer at King's College London until she became a Reader at the University of Essex in 1992. In 1990, she was appointed legal advisor on the European Company Statue in the House of Lords' Committee on the European Communities. From 1992-2001 she was appointed by the UK Treasury as a Commissioner for Friendly Societies. She was promoted to a Chair at Essex and was Head of the Law School from 1994-1997. In 2000, she published the monograph: *The Governance of Corporate Groups*, Cambridge University Press 2000. Further works are *Company, International Trade and Human Rights*, CUP, 2005. A project funded by the AHRC was the outcome of *The Processes practices of Fairtrade: Thrust, Ethics and Governance (edited)* with Brigitte Glanville. In 2005, she was appointed the Director of the Centre of Commercial Law Studies at Queen Mary University of London. In 2003, she was appointed a commercial law expert in a project funded by the World Bank, the EU and the (GIZ) GmbH where she works in a number of the Balkan states. With Michael Blecher, she drafted "Albanian Law 9901 on Entrepreneurs and Companies" of 14 April 2008. Recent publications include, *The Nature of Corporate Governance; The Significance of Natural Culture Identity,* Edward Elgar, with Marios Koutsias, 2013 and also with Koutsias, "The Three Shades of Tax Avoidance of Corporate Groups: Company Law, Ethics and the Multiplicity of Jurisdictions Involved", EBLR 2019.

Martin Gelter is a Professor and an expert in comparative corporate law and governance. In 2009, he joined Fordham Law School. Previously, he was an assistant professor at the Department of Civil Law and Business Law at the WU Vienna University of Economics. Furthermore, he has been a Considine Fellow in Law and Economics at Harvard Law School, a Visiting Fellow at the University of Bologna, and a Visiting Professor at the University of Paris-II (2013) and at National Taiwan University (2018). Since 2006, he has been a research member of the European Corporate Governance Institute. In the past years, he has frequently taught training programs for judges in corporate law in the Republic of Georgia. He holds degrees in law from the University of Vienna (Mag.iur., Dr.iur.), in business administration from WU Vienna University of Economics (Mag.rer.soc.oec., Dr.rer.soc.oec.), an S.J.D. from Harvard Law School, and an M.A. in Quantitative Methods for the Social Sciences from Columbia University. His scholarship has appeared in numerous journals and books both in Europe and in the United States.

Mariangela Iannaccone is a post doctorate researcher in EU Company Law at the Department of Law, Aarhus University, Denmark. After graduating with honors in law at the University of Naples, she took a PhD in Contract law and Business Administration at the Faculty of Economics at Sapienza University of Rome. Her research focuses on company law, corporate governance and contract law. She has held visiting posts at the University of Oxford (2013-2014) and Max Planck Institute for Comparative and International Private Law where she was awarded a visiting fellowship in 2016. In 2018, she obtained a grant from the Aarhus University Research Foundation to carry out research on dual class stocks at University of California, Boalt Hall School of Law, Berkeley. She is a member of the ECGI (European Corporate Governance Institute) and of AIDC (*Associazione Italiana Diritto Comparato).*

Stephan Madaus is a Professor at Martin Luther University Halle-Wittenberg (Germany) where he teaches German, European and international insolvency law as well as contract and tort law. He is a member of the International Insolvency Institute and a Founding Member of the Executive of the Conference of European Restructuring and Insolvency Law (CERIL). In 2017, he was mandated (with two colleagues) by the German Ministry of Justice to evaluate the 2012 reform of the German Insolvency Code. From 2013-2017 he worked with prof. Bob Wessels as a Reporter for the European Law Institute's Project on the 'Rescue of Business in Insolvency Law'. He has published in prominent legal journals in Germany, Europe and beyond, including a treatise on the fundamental and doctrinal nature of rescue plans entitled *Der Insolvenzplan*.

Natalie Videbæk Munkholm, ph.d., is an Associate Professor at the Department of Law, Aarhus BSS, Aarhus University, and specialises in labour and employment law, European Labour Law and fundamental rights at work. She is the National Expert for Denmark to the European Labour Law Network (ELLN), the Danish expert to the Restatement of Labour Law in Europe project, the representative of Denmark to the International Society of Labour and Social Security Law (ISLSSL), appointed by the Minister of Employment to the Board of Equal Treatment, board member of the Danish Association for Labour Law, and chairman of the board of the Danish Labour Law Research Foundation. She participates and partners in a number of European and Nordic research projects on labour law and European labour law, including the

2017-2019 ETUI project on posting of workers. She has conducted research at Oslo University, Cambridge University and Helsinki University, and publishes internationally as well as in Denmark. Natalie holds law degrees from Denmark, BAjur (AU), cand. jur. (AU), and Australia, LL.M. (UNSW). Before entering academia, she worked 14 years as a practitioner with labour and employment law in Denmark, Australia and New Zealand, and taught as an external lecturer in labour and employment law at Aarhus University and (then) Aarhus School of Business.

Florian Möslein is a Director of the Institute for Law and Regulation of Digitalisation (www.irdi.institute) and a Professor of Law at the Philipps-University Marburg, where he teaches Contract Law, Company Law, and Capital Markets Law. He previously held academic positions at the Universities of Bremen, St. Gallen, and Berlin, and visiting fellowships in Italy (Florence, European University Institute), the US (Stanford and Berkeley), and Australia (University of Sydney). Having graduated from the Faculty of Law in Munich, he also holds academic degrees from the University of Paris-Assas (licence en droit) and London (LL.M. in International Business Law). Florian Möslein published three monographs and over 80 articles and book contributions, and has edited seven books. His current research focus is on regulatory theory, corporate sustainability and the legal challenges of the digital age.

Pasquale Pistone is a Professor, Dr. He is an Academic Chairman of IBFD (Netherlands). Holder of a Jean Monnet *ad personam* Chair in European Tax Law and Policy at WU Vienna (Austria). Habilitated as a Full Professor in Italy and Associate Professor of Tax Law at the University of Salerno (Italy). Professor *honoris causa* at the Ural State Law University (Russia) and at the University of Cape Town (South Africa). Member of the Executive Board and Secretary General of the European Association of Tax Law Professors (EATLP), Member of the Permanent Scientific Committee of the International Fiscal Association (IFA) and of the ECJ Task Force on direct tax law of the *Confédération Fiscale Européenne* (CFE). (Co-)Director on the IBFD Observatory on Taxpayers´ Rights. Editor-in-chief of the IBFD World Tax Journal, the International Tax Studies and of the Doctoral Series. Executive editor of the IBFD Global Tax Treaty Commentaries. Co-editor of *Diritto e Pratica Tributaria Internazionale*. Fluent in seven languages. Has authored 4 and (co-)edited 56 books and 213 articles and book chapters, published in eleven languages. Most publications focus on international and European tax law.

Carsten Schirrmacher is a senior lecturer and post-doc researcher at the Department of Law, Justus-Liebig-University Giessen, Germany (at the Chair of Private Law, Business and Commercial Law, Comparative Law). He holds a German PhD degree from the European University Viadrina, Frankfurt (Oder); his PhD thesis dealt with the abuse of companies committed by municipalities. He has published several articles on issues related to Company Law, Capital Market Law and financial supervision. He currently works on a commentary on the German Takeover Act.

Björn Schneider is a junior lecturer at the Department of Law, Justus-Liebig-University Giessen, Germany (as an assistant to Professor Jens Ekkenga, Chair for Private Law, Business- and Commercial Law, Comparative Law). As a scholar of the Konrad

Adenauer Foundation (since 2017), he works on his PhD thesis related to Company Law and Accounting Law. His research interests include Tort Law, Company Law, Accounting Law, Insolvency Law and Capital Market Law. He has published several articles on issues related to these areas, and together with Professor Ekkenga he currently works on a commentary on Sec. 15 German Limited Liability Company Act (transfer of shares).

Konstantinos Sergakis is Professor of Commercial Law at the University of Glasgow. He is also Director of the LLM in Corporate & Financial Law and School Director of Internationalisation. He has co-edited scientific volumes and authored numerous journal articles in prestigious journals across the globe as well as two books. He has held a number of visiting Professorships at Aarhus, Alcalá, Sciences-Po Lyon and UCLouvain. He currently sits on the editorial board of the journals *Corporate Ownership and Control* and *Corporate Governance and Sustainability Review*. He is also a member of the Executive Board of the International Association of Economic Law.

Christoph Teichmann is a Professor at the University of Wuerzburg, Germany, where he teaches civil law, German and European commercial and company law. He graduated at the University of Heidelberg where he also obtained his doctoral degree. He then worked for two years as a lawyer for a law firm in Frankfurt, Germany. In 1998, he returned to the University of Heidelberg where he wrote his habilitation thesis (*Binnenmarktkonformes Gesellschaftsrecht*). He worked as a lecturer at the universities of Heidelberg and Bielefeld. In 2007, he accepted a chair (tenure track) at the University of Wuerzburg. His research is focusing on German, comparative and European company law. He is a co-editor of ZGR (*Zeitschrift für Unternehmens- und Gesellschaftsrecht*) and ECFR (*European Company and Financial Law Review*) and a member of several international working groups on company law, including the EMCA group (*European Model Company Act*) and the ICLEG (*Informal Company Law Expert Group*).

Christoph van der Elst is a Professor of Business Law and Economics at Tilburg University (the Netherlands) and at Ghent University (Belgium), lecturing in the field of corporate law (and its economic analysis), corporate governance, and commercial contracts. He has also published widely on these topics. He holds a master in law and a master in economics as well, and he has obtained a PhD in economics. He is an ECGI Research Associate, member of the Belgian Bar (Cottyn) and member of the audit committee of the Ghent University Hospital.

Lécia Vicente is an Assistant Professor of Law at the Louisiana State University Law Center. She teaches in the areas of business law and civil law. Before joining LSU Law, she was an affiliate with Fordham Corporate Law Center at the Fordham University School of Law, a postdoctoral research associate and lecturer in Business Law at the University of Illinois at Urbana-Champaign, and a researcher at the European University Institute in Florence, Italy. She earned her Ph.D. and Master of Laws in Comparative, European and International Laws from the European University Institute and her BA in Law from the Catholic University of Portugal. Before her teaching and research appointments, she was a practicing lawyer at international law firms where she worked on corporate, contract, real estate and civil procedure laws of Portugal and other

Lusophone countries such as Angola, Mozambique, and Brazil. She held visiting research positions at the Commercial Law Department of the Faculty of Law of the Universidad Autónoma de Madrid, the University of Illinois College of Law, Fordham University Law School, the Institute of International Economic Law at the Faculty of Law of the University of Helsinki, and the Institute of Social Sciences of the University of Lisbon. Additionally, she has been a pro-Bono Adviser and Head of Delegation of the African Union at the United Nations High-Level Political Forum on Sustainable Development under the Auspices of United Nations Economic and Social Council and the United Nations Sustainable Development Summit for the adoption of the Post-2015 development agenda. Her work is mostly interdisciplinary, and her main areas of interest are business law, civil law, corporate and comparative corporate law, contract law, law and economics, corporate and contract governance, history of corporations, and legal theory.

Michelle Welsh is a Professor and the Head of the Department of Business Law and Taxation, and Director of the Ethical Regulation Research Group at the Monash Business School. She undertakes research on the public enforcement of corporate law, the role of the public regulator and the impact of enforcement on corporate compliance. She has published in Australian and international journals. Her recent work includes an Australian Research Council funded three-year project titled ‘Phoenix Activity: Regulating Fraudulent Use of the Corporate Form’ with colleagues from the Melbourne Law School.

Summary of Contents

Editors v

Contributors vii

Part I
Distinguishing Abuse from Non-abusive Use of Companies 1

Chapter 1
Abuse of Companies: An Introduction
Hanne S. Birkmose, Mette Neville & Karsten Engsig Sørensen 3

Chapter 2
Abuse of Companies Through Choice of Incorporation?
Martin Gelter & Lécia Vicente 13

Chapter 3
The Abuse of Company Groups
Janet Dine 35

Chapter 4
Phoenix Companies as an Abuse of Companies
Michelle Welsh & Helen Anderson 59

Chapter 5
Circumvention of Board Level Representation of Employees
Christoph Teichmann 79

Part II
Tackling Abuse in Company Law 115

Chapter 6
Digital Abuse of Companies: Formation, Filing and Evasion
Florian Möslein 117

Chapter 7
The Liability of Directors and the Abuse of Companies
Mariangela Iannaccone & Anna Rosa Adiutori 141

Chapter 8
Veil Piercing and Abuse of the Corporate Form
Diederik Bruloot, Louis De Meulemeester & Christoph Van der Elst 159

Chapter 9
Capital Requirements and the Abuse of Companies
Alessio Bartolacelli 179

Chapter 10
Unmasking Shareholders and Directors to Prevent the Abuse of Companies
Blanaid Clarke 209

Part III
Tackling Abuse in Other Areas 231

Chapter 11
Abuse of Companies in Capital Market Law
Carsten Schirrmacher & Björn Schneider 233

Chapter 12
Free Movement in the EU and the Abuse of Companies
Karsten Engsig Sørensen 259

Chapter 13
Anti-money Laundering Rules Against Abuses of Companies
Konstantinos Sergakis 287

Chapter 14
Abuse of Companies and the Prohibition of Abusive Tax Practices
Pasquale Pistone 309

Chapter 15
Abuse of Companies and Insolvency Law
Stephan Madaus 329

Chapter 16
Abuse of Companies and Posting of Workers
Natalie Videbæk Munkholm 343

Bibliography 369

Table of Contents

Editors v

Contributors vii

Part I
Distinguishing Abuse from Non-abusive Use of Companies 1

Chapter 1
Abuse of Companies: An Introduction
Hanne S. Birkmose, Mette Neville & Karsten Engsig Sørensen 3
§1.01 The Topic 3
§1.02 What Constitutes Abuse? 4
§1.03 Tackling Abuse in Company Law 6
§1.04 Tackling Abuse in Other Areas of Law 8
§1.05 Conclusions 10

Chapter 2
Abuse of Companies Through Choice of Incorporation?
Martin Gelter & Lécia Vicente 13
§2.01 Introduction 13
§2.02 Cross-Border Incorporation of Privately Held Firms 14
[A] Cross-Border Incorporations in Europe 15
[1] No Abuse after Centros? 15
[2] Ex Ante Hurdles Against the Choice of Jurisdiction as Justifiable Shields Against Abuse? 17
[B] Abuse by the Choice of Jurisdiction in the US? 22
[1] The Internal Affairs Rule 22
[2] Pseudo-Foreign Incorporation Statutes 24
§2.03 Cross-Border Mergers, Including ‘Reverse Mergers’ 26
§2.04 A Brief Note on Cross-Border Transfers of Seat 31
§2.05 Conclusion 32

Chapter 3
The Abuse of Company Groups
Janet Dine 35
§3.01 Introduction 35
§3.02 Fake Bargains and a Mechanical Use of Abuse of Companies 37
§3.03 Incorporation as a Governmental Tool 38
§3.04 MNE Accountability Challenges 40
§3.05 The Behaviour Conundrum 46
§3.06 Trading and Possessions 47
[A] The Neo-liberal Paradigm: Rationality and Selfishness 48
§3.07 Tax Avoidance, by MNEs and the Purpose of Tax 53
§3.08 Conclusion 57

Chapter 4
Phoenix Companies as an Abuse of Companies
Michelle Welsh & Helen Anderson 59
§4.01 Introduction 59
§4.02 Phoenix Activity and Its Cost 61
§4.03 Categories of Phoenix Activity 62
[A] The Legitimate Phoenix or Business Rescue 62
[B] The Problematic Phoenix 63
[C] Illegal Phoenix Type I: Intention to Phoenix Formed as Company Begins to Fail 64
[D] Illegal Phoenix Type II: Phoenix as a Business Model 64
[E] Illegal Phoenix Type III: Complex Illegal Activity 65
§4.04 Drawing the Line Between Creative Use and the Abuse of the Corporate Form 65
[A] The Problematic Phoenix: Creative Use or Abuse of the Corporate Form? 67
[1] The Rights Versus Privilege Debate 67
[2] Current Measures Dealing with Problematic Phoenix Activity 71
§4.05 Conclusion 75

Chapter 5
Circumvention of Board Level Representation of Employees
Christoph Teichmann 79
§5.01 Introduction and Terminology 79
§5.02 Diversity of Corporate Governance Systems 80
[A] The Two-Tier System 80
[1] The Separation of Management and Supervision 80
[2] Nomination and Revocation of Management Board Members 81
[3] Incompatibility of Membership 82

[4] The Intricate Interconnection of Management and Supervision 82
[B] The One-Tier System 83
[C] The European Company (SE) 85
[D] Corporate Governance and BLER 85
§5.03 Basic Features of the German Co-determination System 86
[A] Mandatory Nature of Co-determination 86
[B] Scope of Application of Co-determination Rules 87
[C] Powers of Employee Representatives on the Supervisory Board 89
[D] Final Assessment 90
§5.04 Escape Route No. 1: The European Company 90
[A] The Historic Evolution of the 'Before and After' Principle 90
[1] Early Attempts to Introduce a European Company *(Societas Europaea)* 90
[2] The Solution Found by the Davignon Group 91
[3] The Directive on the Involvement of Employees in the European Company 92
[B] Attractiveness of the SE for Companies with Co-determination 94
[1] Reducing the Size of the Supervisory Board 94
[2] 'Freezing' of Co-determination 95
[3] Freezing What Actually Is or What Legally Should Be the Proportion of Employee Representatives? 96
[4] Getting Rid of Trade Unions on the Supervisory Board 97
§5.05 Escape Route No. 2: Cross-Border Merger 99
[A] Legal Basis in Secondary Law 99
[B] Similarities and Differences Compared to the European Company 99
§5.06 Escape Route No. 3: Foreign Legal Entities 100
[A] The Rise and Fall of 'Pseudo-Foreign Companies' in Germany 100
[B] Why German Co-determination Does Not Apply to Foreign Legal Entities 102
[1] Freedom of Establishment 102
[2] International Private Law 102
[3] Restricted Scope of Application of Substantive Co-determination Law 103
[4] Continuing Attractiveness of Foreign Legal Entities 103
[C] How German Co-determination Could Be Applied to Foreign Legal Entities 105
§5.07 Does Evading Co-determination Constitute Abuse of the Corporate Form? 107
[A] Abuse of Freedom of Establishment 107
[B] The European Company 108
[C] The 'Company Law Package' and Abusive Cross-Border Transactions 110
[1] Application of the Before and After Principle 110

[2] Refusal of Pre-conversion Certificate in Cases of Abuse 111
§5.08 Final Conclusions 112

PART II
Tackling Abuse in Company Law 115

CHAPTER 6
Digital Abuse of Companies: Formation, Filing and Evasion
Florian Möslein 117
§6.01 Abuse of Digital Tools in Company Law 117
[A] Abuse of Law and Its Key Elements 118
[B] Abuse of Rights and Abuse of the Corporate Form 119
[C] Digital Abuse of Companies 122
[D] Digital Tools 124
§6.02 Formation of Companies 125
[A] Relevance for Cross-Border Mobility 125
[1] Previous Attempts at Harmonization 125
[2] Divergence of National Rules 126
[B] Potential for Abuse 126
[1] Purely Procedural Harmonization 127
[2] Existence of Specific Anti-abuse Rules 127
[3] Safeguards Against Fraud and Abuse in the Proposal 128
[C] Rules on Online Formation 129
[1] Online-Only Principle 129
[2] Scope of Application 130
[3] Procedural Aspects 131
§6.03 Filing of Documents 133
[A] Register-Only Principle 133
[B] Online-Only Filing 134
[C] Online Registration of Branches 135
§6.04 Evasion of Company Law 135
[A] The Regulatory Character of Digital Tools 135
[B] Functional Equivalents to Company Law Rules 137
[C] Digital Abuse or Use of Private Autonomy? 138
§6.05 Conclusion 139

CHAPTER 7
The Liability of Directors and the Abuse of Companies
Mariangela Iannaccone & Anna Rosa Adiutori 141
§7.01 Introduction 141
§7.02 The Liability of Directors and the Abuse of Companies under the General Principles of Company Law 142
[A] The Liability of Directors in the Event of Money Laundering 144
§7.03 The Concept of Shadow Director as a Means of Tackling the Abuse of the Companies 147

[A] The Application of Directors' Duties to the Shadow Director 148
[B] The Concept of *Amministratore Di Fatto* under Italian Law 151
§7.04 The Liability of the Parent Company as a De Facto or Shadow Director 153
§7.05 Conclusions 156

CHAPTER 8
Veil Piercing and Abuse of the Corporate Form
Diederik Bruloot, Louis De Meulemeester & Christoph Van der Elst 159
§8.01 Introduction 159
§8.02 Veil Piercing: A Divergent Concept 160
[A] Denying Legal Personality Versus Denying Limited Liability 160
[B] Diverging Incidence 161
[C] Abuse of Companies Versus Abuse in Companies 162
§8.03 Types of Abuse That Lead to Veil Piercing 162
[A] Disregarding of the Corporate Form 163
[1] Introduction 163
[2] The US Approach 163
[a] Overview 163
[b] A Two-Pronged Test 164
[3] Continental European Experiences 167
[B] Undercapitalisation 169
[1] Overview 169
[2] Asset Stripping 170
[3] Undercapitalisation upon Formation 172
[4] Undercapitalisation in Other Stages of the Corporate Lifecycle 173
[C] Intermediary Conclusion 175
§8.04 Abuse of Companies, Veil Piercing and the Role of Statutory Law 176
§8.05 Conclusion 178

CHAPTER 9
Capital Requirements and the Abuse of Companies
Alessio Bartolacelli 179
§9.01 Introduction 179
§9.02 A Company's Capital: Requirements, Use and Abuse 179
§9.03 Capital's Functions and Different Company Forms 182
§9.04 Capital as a 'Threshold of Seriousness': The Price for Limited Liability 184
§9.05 Capital-Related Abuse of Companies in Public and Private Companies 186
[A] European Public Companies 186
[B] European Private Companies 189
[1] Capital's Effectiveness in Private Companies 192
[2] Capital's Maintenance in Private Companies 194
§9.06 New Trends on Minimum Capital in Private Companies 197
[A] Radical Capital Reduction Approach 198

[B] New Sub-versions Creation Approach (and Their Mandatory Tied-Up Reserves) 201
[C] Delayed Capital Formation Approach 205
§9.07 Final Remarks 206

Chapter 10
Unmasking Shareholders and Directors to Prevent the Abuse of Companies
Blanaid Clarke 209
§10.01 Introduction 209
§10.02 Lack of Transparency as an Abuse 210
[A] Use of the Company for Illicit Activities 211
[B] Concealment of Ownership 212
[C] Privacy Rights 214
[D] Investment Chains 218
§10.03 Nominee Shareholders 219
§10.04 Bearer Shares 222
§10.05 Nominee Directors 224
[A] Nominee Directors 224
[B] Corporate Directors 228
§10.06 Conclusion 230

Part III
Tackling Abuse in Other Areas 231

Chapter 11
Abuse of Companies in Capital Market Law
Carsten Schirrmacher & Björn Schneider 233
§11.01 Introduction and Overview 233
§11.02 Loopholes and Abuse of Companies 233
[A] Purposes of Capital Market Law … and How to Achieve Them 234
[B] Ways to Circumvent Capital Market Law 235
[1] 'Übertragende Auflösung' 236
[2] Managers' Transactions in Shares 236
[C] The General Principle Prohibiting the Abuse of Rights in Capital Market Law 237
[1] The Objective Element 237
[a] General Remarks 237
[b] Identifying a Rule's Purpose 238
[c] Objective Matters: Application to the Examples 238
[2] The Subjective Element in Capital Market Law 240
[a] General Remarks 240
[b] Application of These Criteria in Capital Market Law? 240
[3] (No) Justification 242

[D] Methods of Tackling the Circumvention of Capital Market Law 242
[1] Application of Written Law by the Courts 242
[2] Legislation 243
[a] Outcome-Oriented Legislation 243
[b] Behaviour-Oriented Legislation 243
[3] Harmonization as a Special Means of Legislation: The Example of Insider Dealing 245
§11.03 Effective Enforcement of Capital Market Law: How to Tackle the Abuse of Opaque Company Networks to Conceal Illegal Acts? 246
[A] Dissuasive Sanctions in Capital Market Law 247
[1] Criminal Sanctions 247
[2] Supervision and Administrative Sanctions 247
[3] Civil Liability 248
[4] Special Sanctions: Suspension of Voting Rights 249
[B] Instruments of Detecting Concealing Practices 250
[1] A Qualitative Approach: The Promotion of Whistle-Blowing 251
[2] Quantitative Approaches 252
§11.04 Finally: (Ab)use of Blockchain-Based Companies to Evade Capital Market Law 252
[A] Factual Background: The Use of DAOs and ICOs as a Functional Equivalent to Listed Stock Corporations and IPOs 253
[B] DAOs and ICOs as a Subject of Capital Market Law 254
[1] Requirements for the Classification of Tokens as Securities 254
[2] Regulatory Agency Statements: A Brief Overview 255
[C] The Law in the Books and the Law in Action: The Use of DAOs as an Abuse of Companies in Capital Market Law? 255
[1] Frictions Between Capital Market Law and Code: Tendencies to (Ab)use It 255
[2] Regulatory Outlook 257
§11.05 Conclusion 257

CHAPTER 12
Free Movement in the EU and the Abuse of Companies
Karsten Engsig Sørensen 259
§12.01 The Topic 259
§12.02 The General Principle Prohibiting Abuse of EU Law 260
§12.03 Formation of a New Company 262
§12.04 Conducting Business in Other Member States 265
[A] Setting up Branches 265
[B] Group Structures 268
[C] The Provision of Services 271
§12.05 Corporate Cross-Border Restructuring 275
[A] Cross-Border Conversion of Companies 275

[1] Conversions Based on Article 49 TFEU 275
[a] The Judgment in Polbud 276
[b] Reconciling Polbud with Earlier Case Law 277
[c] Preventing Abuse after Polbud 280
[2] Proposal on Cross-Border Conversion 281
[B] Cross-Border Mergers and Divisions 285
§12.06 Conclusions 285

CHAPTER 13
Anti-money Laundering Rules Against Abuses of Companies
Konstantinos Sergakis 287
§13.01 Introduction 287
§13.02 The AML Beneficial Ownership Transparency Framework 288
[A] The Notion of Beneficial Ownership 288
[B] Collecting and Disclosing Information on Beneficial Ownership 293
[1] Central Registers 294
[2] Customer Due Diligence by Obliged Entities 295
[3] The Shift to Public Access to Beneficial Ownership Information 296
[4] The European Central Platform 298
§13.03 Supervision 299
[A] Financial Intelligence Units 299
[B] National Competent Authorities 300
[C] Cooperation at National and EU Levels 301
[D] Reinforcement of Supervision: The 2018 Proposals 302
§13.04 Sanctions 303
[A] The Preponderance of Administrative Sanctions and Measures 303
[B] The Rarity of Criminal Sanctions 305
[C] The lack of Private Enforcement 306
§13.05 Conclusion 306

CHAPTER 14
Abuse of Companies and the Prohibition of Abusive Tax Practices
Pasquale Pistone 309
§14.01 Scope 309
§14.02 The Evolution of the Prohibition of Abusive Practices in CJEU's Tax Case Law 312
§14.03 The Constituent Elements of Abusive Tax Practices 314
§14.04 The Five Indicators of Artificial Tax Arrangements 321
§14.05 Reconciling Secondary Law with the Standards of the CJEU for Countering Abusive Tax Practices 323
§14.06 Concluding Remarks 328

Chapter 15
Abuse of Companies and Insolvency Law
Stephan Madaus 329
§15.01 Introduction 329
§15.02 Discovering Abuse in Insolvency Proceedings 330
[A] Scrutiny, Transparency and Enforcement 330
[B] Safeguarding the Commencement of Insolvency Proceedings 331
[C] Preventing Forum Avoidance by Forum Shopping 333
§15.03 Pursing Damages and Avoidance Claims 334
[A] Enforcing Company Law Claims in Insolvency Proceedings 335
[B] Enforcing Insolvency Law Claims 336
[C] Disqualification of Directors 336
§15.04 Disregarding the Corporate Form in a Group Insolvency Context 337
[A] Specific Challenges in the Insolvency of Corporate Groups 337
[B] The Current Standard of Communication and Cooperation 339
[C] Substantive Consolidation as a Powerful Tool 340
§15.05 Conclusion 341

Chapter 16
Abuse of Companies and Posting of Workers
Natalie Videbæk Munkholm 343
§16.01 Introduction 343
§16.02 The Background of the Posted Workers Directive 345
§16.03 The Posted Workers Directive and Its Shortcomings 346
[A] Specific Examples: Cases of Abuse of Posting 347
[1] Transportation Sector: Letterbox Companies Set up in Eastern Europe to Serve as Employers to Construction and Transport Workers in Western Europe 348
[2] Meat Industry, German Case: Webs of Letterbox Companies Used for Subcontracting 350
[B] Freedom to Provide Services and Freedom of Establishment 351
[C] A General EU Law Principle Prohibiting Abuse of Rights 353
[D] Social Security and Posting 354
[E] Political Responses 357
§16.04 The Enforcement Directive and the Amendment to the Posted Workers Directive 358
[A] The Enforcement Directive 358
[1] Discussion 359
[2] Application 362
[B] The Amendment to the Posted Workers Directive 364
§16.05 Discussion and Concluding Remarks 366

Bibliography 369

CHAPTER 8

Veil Piercing and Abuse of the Corporate Form

Diederik Bruloot, Louis De Meulemeester & Christoph Van der Elst

§8.01 INTRODUCTION

Limited liability is considered one of the key features of the company.[1] However, it comes at a cost: it shifts risks from shareholders to creditors who do not necessarily have the possibility to protect themselves. It opens the doors for abusive use of the protective mechanism of limited liability. Hence the question is raised how legal instruments can help to mitigate this risk. Piercing the corporate veil is considered one of the traditional techniques to protect third parties against the risks stemming from limited liability, next to the directors' liability for breach of their, often very broadly defined, duties vis-à-vis the company.[2] This chapter specifically examines the concept 'veil piercing' as one of the core remedies in case of abuse of companies. Particularly, it aims at identifying the different types of abuse of companies that can lead to veil piercing. 'Veil piercing' turns to be a highly divergent concept but shows the key characteristic that there is a court order that sets aside legal personality or limited liability of the company leading to the personal liability of shareholders for the debts of the company.

By drawing up our typology regarding types of abuse that can lead to veil piercing, we take an international, comparative viewpoint, searching for what could be called 'generally accepted principles' on veil piercing in case of abuse of companies, rather than collating a complete catalogue of the different grounds on which the

1. J. Armour, H. Hansmann, R. Kraakman, M. Pargendler, *What is corporate law?* in R. Kraakman, J. Armour, P. Davies et al. (eds.), *The anatomy of corporate law: a comparative and functional approach*, Oxford University Press, 5 (2017).
2. For a detailed assessment of directors' liability for abusing the company, *see* Chapter 7 of this book.

corporate veil is being pierced around the world. As other chapters in this book focus on different aspects of abuse of companies, this chapter specifically addresses the piercing of the corporate veil vis-à-vis shareholders.

This contribution starts with setting out the basic characteristics of veil piercing by particularly explaining the highly divergent character of veil piercing (section §8.02). It then turns to a typology and analysis of these types of abuse that are most common to lead to veil piercing (section §8.03). Finally, we put forward some insights regarding the role that legislators can play in reducing the uncertainty caused by the concept of veil piercing.

§8.02 VEIL PIERCING: A DIVERGENT CONCEPT

[A] Denying Legal Personality Versus Denying Limited Liability

'Veil piercing' or 'lifting the corporate veil' are concepts that, in different ways, can be found in almost all jurisdictions.[3] It seems to serve as an inevitable – be it often underdeveloped – complement to the concepts of legal personality and limited liability. In some but highly exceptional circumstances, the legal fiction that is being created by one of the aforementioned concepts can be set aside by a court. In that respect, a distinction must be made between a court denying the legal personality of a legal entity or denying the limited liability of a company's shareholders. As veil piercing is used to the benefit of (defrauded) creditors, their interests are considered to be best served with a court decision that holds the shareholders (or some among them) personally liable for the company's debts (wholly or partially). The company itself (the legal entity) remains in existence and can, for instance, still be put in a formal insolvency proceeding.

The other seemingly more far-reaching option is that the court denies the entire legal fiction of legal personality, thus treating the persons behind the corporate veil as would there be no legal entity at all. At first sight, this option seems to differ predominantly from the other because the legal entity is no longer existing for other purposes, such as for instance the winding up of the entity within a formal insolvency proceeding. In practice, however, this option proves to be particularly helpful in cases of fraudulent asset shielding. This refers to situations in which individuals, whether or not incorporated, defraud their creditors by shifting assets to separate legal entities, thus avoiding that creditors of those individuals can seize their assets. By piercing the corporate veil of the latter entities, creditors can execute their rights on the unlawfully

3. For a historical overview of the development of veil piercing *see* Cheng Han, W. Jiangyu, C. Hofmann, *Piercing the corporate veil: Historical, theoretical and comparative perspectives*, NUS law working paper series 2018/025, 2-10, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3254130 (accessed 11 Apr. 2019).

shielded assets. It shows that veil piercing is a relevant technique for both limited liability companies and partnership-type entities.[4]

It should further be noted that in other legal areas outside company law, multiple companies or a company and the controlling shareholder are sometimes qualified as one legal entity for specific duties and liabilities (usually called 'enterprise doctrine' or 'economic unity doctrine')[5]. This is for instance clearly the case in European competition law where the legal form is in principle irrelevant to the identification of the enterprise concerned. This chapter focuses solely on veil piercing in company law.

[B] Diverging Incidence

Immediately after limited liability and the separate legal form became the new standard, it was generally perceived that it comes with certain limits. It cannot be extended beyond its reason.[6] However, a straightforward theory identifying the appropriate application of both key features is not developed. Case law filled this gap. Nevertheless, as far as we could ascertain there are only few empirical studies assessing the likelihood of how often courts pierce the corporate veil. Ramsay and Noakes found that Australian courts pierced the corporate veil in 39% of the cases where the plaintiff requested veil piercing, this percentage being lower if the shareholders are legal entities.[7] In China and the United Kingdom, court cases show higher levels of veil piercing of more than 60%[8] and almost 50% respectively,[9] but in the latter country, in 2013, the House of Lords introduced guiding principles which make veil piercing less likely.[10] American studies show veil piercing rates from 35% to 49% with significant variety in the number of investigated cases.[11]

A recent empirical study assessed how readily the courts in different countries are receptive to piercing the corporate veil. Thereto, the authors analysed 16 countries where the law is familiar with the enterprise approach '*a concept that allows courts to pierce the corporate veil under the premise that a parent firm and its subsidiaries constitute a single entity*'.[12] Furthermore, the scholars assessed how many factors the court is willing to take into account for piercing the corporate veil, whether piercing the veil is limited to insolvency or fraud and a likelihood score of veil piercing in a country

4. I.e. entities with legal personality having their own assets and debts, but in which the partners bare unlimited liability for the debts of the partnership. The separate legal personality makes its assets unavailable for attachment by the partners' personal creditors.
5. K. Vandekerckhove, *Piercing the corporate veil,* Kluwer Law International, 381 (2007).
6. Tan Cheng Han, *Veil Piercing: A Fresh Start*, Journal of Business Law 20, 29 (2015).
7. Ramsay and Noakes, Piercing the Corporate Veil in Australia, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=299488 (accessed 11 Apr. 2019).
8. Hui Huang, *Piercing the Corporate Veil in China: Where Is It Now and Where Is It Heading*, 60 American Journal of Comparative Law 743, 746 (2012).
9. Charles Mitchell, *Lifting the Corporate Veil in the English Courts: An Empirical Study*, 3 Company Financial & Insolvency Law Review 15 (1999).
10. *Prest v. Petrodel Resources Ltd.,* UKSC (2013).
11. S. Belenzon, H Lee & A. Patacconi, *Towards a legal theory of the firm: The effects of enterprise liability on asset partitioning, decentralization and corporate group growth,* Working Paper NBER no. 24720, n. 130 (June 2018).
12. *Ibid.,* p. 4.

based upon the availability of empirical data.[13] According to that study, the targeted type of veil piercing is the least likely to happen in the UK and Sweden while courts in Germany and Italy are more readily open to veil piercing with the United State and China being in the middle.[14]

[C] Abuse of Companies Versus Abuse in Companies

Distinction should further be made between 'abuse *of* companies' and 'abuse *in* companies'. The first concept is the one which is traditionally linked with veil piercing. A shareholder uses the corporate form and the accompanying limitation of his or her personal liability in order to defraud creditors. When a court comes to this conclusion, it can decide to deny either the entire legal personality of the company as such or 'only' the limited liability of the shareholders (compare *supra)*. The second concept, abuse *in* companies, refers to situations in which companies' insiders (directors and/or shareholders) behave unlawfully and for which behaviour they are held personally liable towards third parties. This personal liability is very similar to the liability a shareholder incurs when a court decides to pierce the corporate veil in case of abuse *of* a company, but it is necessary to distinguish between both concepts.

In this chapter, we basically focus on 'abuse *of* companies', and thus not on insiders' personal liability towards third parties (particularly creditors) as a result of certain unlawful or even fraudulent behaviour within a company. However, it should be noted that although distinct, both concepts (abuse *of* vs. abuse *in* companies) are closely intertwined and are frequently at stake at the same time. This is actually true for all cases of 'abuse *of* companies' as abuse of the entire corporate form will inevitably come with unlawful acts by insiders. In those cases, creditors can actually choose one of the concepts to rely on in order to hold the insiders personally liable. The close relationship between both concepts can probably explain why courts often do not distinguish between them.[15]

§8.03 TYPES OF ABUSE THAT LEAD TO VEIL PIERCING

The existing materials on veil piercing allow us to distinguish between two main categories of abusive situations in which courts decide to pierce the corporate veil. It concerns [A] a factual situation in which there is complete disregarding of the corporate form and [B] different kinds of situations of undercapitalisation of the company.

---

13. This likelihood is commonly zero as empirical data are only available in the US, the UK, Australia and China.
14. The results should be read with caution as the authors weighed the results and provided the most weight to the enterprise approach, being the highest in Germany as the latter country developed group law.
15. K. Vandekerckhove, *Piercing the corporate veil,* Kluwer Law International, 12 (2007).

[A] Disregarding of the Corporate Form

[1] Introduction

A first category of situations that can lead to veil piercing can be labelled as 'disregarding of the corporate form'. This concept broadly refers to situations in which a company has no real separate existence from its shareholder, being only but a 'shield' behind which shareholders hide.

A company is a separate legal person, independent from its shareholders, which can be granted the benefit of limited liability. However, in certain circumstances, shareholders can wrongfully dominate the company in their sole interest and to the detriment of creditors. In those circumstances, courts sometimes lift the corporate veil, particularly when they find that the company and its shareholder(s) need to be assimilated and thus to be considered as one person because they are too intermingled, and therefore the shareholders should not benefit from the advantage of limited liability related to the legal form.

[2] The US Approach

[a] Overview

Compared with other jurisdictions, in the US, veil piercing is well studied and reported. According to these studies, courts frequently pierce the corporate veil when they conclude that a company is a mere 'agent', 'instrumentality', 'alter ego', 'dummy' or 'shell' for its shareholders. In his 1991 empirical research, Professor Thompson found that in 'successful' veil piercing cases one or more of these elements were almost always mentioned by the courts.[16] The underlying idea is that when a company has no distinct existence or identity from the dominating shareholders, the company can be used in the sole advantage of the shareholders at the expense of third parties.[17]

The mere fact, however, that a corporation is controlled and dominated by a shareholder does not suffice to conclude that the corporate veil should be pierced. This would undermine the whole purpose and benefit of limited liability.[18] Especially in single member companies or other close corporations with a small number of shareholders, it is quite unrealistic to suppose that the corporate purpose would substantially differ from the interests of the dominating shareholder.[19] In most states, it is

16. R. B. Thompson, *Piercing the corporate veil: an empirical study*, 76 Cornell L. Rev., (1036) 1064 (1991).
17. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability,* Washington & Lee public studies research paper series, Working paper 2006-08, 21, https://papers.ssrn.com/sol3/papers.cfm?abstract_id = 932959 (accessed 11 Apr. 2019).
18. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis,* Elgar Publishing, 92 (2016).
19. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 23, https://papers.ssrn.com/sol3/papers.cfm?abstract_id = 932959 (accessed 11 Apr. 2019).

therefore acknowledged that even the fact that a corporation is a mere alter ego of the individual shareholder does not suffice to conclude to veil piercing.[20]

Traditionally, US veil piercing theory in this respect distinguishes between three different doctrines: the 'instrumentality', the 'alter ego' and the 'identity' doctrine. However, in our view, these theories do not differ substantially from each other, and share identical key elements.[21] Summarised, proof is required that '(1) *the defendant shareholder dominated and controlled the corporation and that* (2) *the defendant abused that control by committing fraud, illegality, or some other form of injustice*'.[22]

[b] A Two-Pronged Test

For the first stage of the two-pronged test (the proof that the company is dominated), courts take multiple factors into consideration. In fact, long 'laundry lists' of factors are frequently used in the assessment of domination. Some of the important examples are:

(1) the commingling of funds and assets
(2) the treatment of the company's assets for personal purposes, or
(3) a failure to maintain minutes or corporate records.[23]

The assessment will always require a case by case analysis, and because the different factors taken into consideration by the courts are unweighted, it is hard to determine which exact factors are decisive.[24] It should be noted that the factors which courts cite go well beyond the normal control of the company ways of 'controlling' and 'dominating' a company, which is typical for majority shareholders. In fact, even without considering the second step in the two-pronged test, this behaviour of the dominant shareholder is unlawful from an internal perspective (abuse *in* companies). Although these acts are already unlawful by themselves (for example, siphoning assets out of a company in breach of the rules on profit distributions), this is not considered sufficient to conclude to veil piercing.

An example of how courts approach veil piercing can be found in the following Seventh Circuit Court of Appeals' opinion in *Sea-Land Services, Inc. v. Pepper Source:*

> The first and most striking feature that emerges from our examination of the record is that these corporate defendants are, indeed, little but Marchese's playthings. Marchese is the sole shareholder of PS, Caribe Crown, Jamar, and Salescaster. He is one of the two shareholders of Tie-Net. Except for Tie-Net, none of the corporations ever held a single corporate meeting. (At the handful of Tie-Net meetings held by Marchese and Andre, no minutes were taken.) During his deposition, Marchese did not remember any of these corporations ever passing

20. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 91 (2016).
21. P. I. Blumberg, *The law of corporate groups,* 111 (1987).
22. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis,* Elgar Publishing, 103 (2016).
23. *Ibid.,* 106.
24. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability,* Washington & Lee public studies research paper series, Working paper 2006-08, 20, https://papers.ssrn.com/sol3/papers.cfm?abstract_id = 932959 (accessed 11 Apr. 2019).

> articles of incorporation, bylaws, or other agreements. As for physical facilities, Marchese runs all of these corporations (including Tie-Net) out of the same, single office, with the same phone line, the same expense accounts, and the like. And how he does "run" the expense accounts! When he fancies to, Marchese "borrows" substantial sums of money from these corporations - interest free, of course. The corporations also "borrow" money from each other when need be, which left at least PS completely out of capital when the Sea-Land bills came due. What's more, Marchese has used the bank accounts of these corporations to pay all kinds of personal expenses, including alimony and child support payments to his ex-wife, education expenses for his children, maintenance of his personal automobiles, health care for his pet - the list goes on and on. Marchese did not even have a personal bank account! (With "corporate" accounts like these, who needs one?).[25]

The failure to observe corporate formalities is frequently mentioned as a reason to pierce the corporate veil.[26] For example, when no general meeting is held, no board of directors is appointed, or when decision making is never documented by board notes, this may indicate that the corporation is merely fictional. However, authors rightfully state that even when corporate formalities are severely neglected, this sole fact can doubtfully be a sufficient basis for veil piercing.[27] There is no necessary causal link between the failure to keep up corporate formalities and a creditor's damage.[28] Nevertheless, Thompson's empirical research showed that the failure to keep corporate formalities was mentioned in two-thirds of successful veil piercing cases, and in more than 90% of unsuccessful piercing cases.[29] Other empirical research confirms these findings.[30]

As already mentioned, mere proof of these elements will not suffice for a successful veil piercing claim as there is a second step to take. Proof of 'fraud, illegality or some other injustice' is necessary. The mere fact that a creditor's claim against the company is unsatisfied is insufficient in that respect as this would be the case with every veil piercing claim.[31] In the case quoted earlier, the US Seventh Circuit held that the additional 'wrongful element' was not proven by the trial court because the decision was only motivated on the ground that due to the limited liability, the companies' creditor would be denied a full judicially-imposed recovery.

25. 941 F.2d 519, 521 (7th Cir. 1991).
26. R. B. Thompson, *Piercing the corporate veil: an empirical study*, 76 Cornell L. Rev., (1036) 1067(1991); D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 25, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).
27. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 25, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).
28. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 109 (2016).
29. R. B. Thompson, *Piercing the corporate veil: an empirical study*, 76 Cornell L. Rev., (1036) 1064 and 1065, n. 141 (1991).
30. P. B. Oh, *Veil piercing*, Texas Law review, (81) 133 (2010).
31. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 113 (2016).

> On remand, the court should require that Sea-Land produce, if it desires summary judgment, evidence and argument that would establish the kind of additional "wrong" present in the above cases. For example, perhaps Sea-Land could establish that Marchese, like Roth in Van Dorn, used these corporate facades to avoid its responsibilities to creditors; or that PS, Marchese, or one of the other corporations will be "unjustly enriched" unless liability is shared by all. Of course, Sea-Land is not required fully to prove intent to defraud, which it probably could not do on summary judgment anyway. But it is required to show the kind of injustice to merit the evocation of the court's essentially equitable power to prevent "injustice." It may well be that, after more of such evidence is adduced, no genuine issue of fact exists to prevent Sea-Land from reaching Marchese's other pet corporations for PS's debt. Or it may be that only a finder of fact will be able to determine whether fraud or "injustice" is involved here. In any event, the record as it currently stands is insufficient to uphold the entry of summary judgment.[32]

As illustrated, the required proof of an additional 'wrong' or fraud next to domination is a barrier to a successful veil piercing claim. Fraud is generally used in a broad sense, as 'bad faith' or 'unfairness', but these vague terms do not give any further clarification on this matter.[33] It is difficult to determine the real decisive factors that courts take into consideration in this second stage of the two-pronged test, which can be seen as the most important cause of the vagueness of the US veil piercing doctrine.[34]

In this respect Macey and Mitts conclude:

> Scholars often claim that the inquiry into whether the corporate form should be disregarded has become oddly separated from the question of why the corporate form should be disregarded. In particular, the generic justifications such as undercapitalization, failure to observe corporate formalities, and preventing injustice offered to justify piercing are unpersuasive because they are either complete non sequiturs or vacuous due to the fact that they are wholly conclusory.[35]

Bainbridge and Henderson argue that courts give:

> ex-post rationalizations of a conclusion reached on grounds that are often unarticulated.[36]

Summarised, veil piercing is a vague concept, and the exact criteria on which US courts base their piercing decisions are rather hard to structure. When it comes to veil piercing because of disregarding of the corporate form, it is clear, however, that courts first make an analysis whether a shareholder dominated the company and conducted business with it disregarding the corporate form (such as asset commingling or absence

32. Sea-Land Services, Inc. v. Pepper Source, 941 F.2d 519, 524 (7th Cir. 1991).
33. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 24, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).
34. H. Hansmann, R. Squire, *External and internal asset partitioning: corporations and subsidiaries* in J.N. Gordon, W-G. Ringe, *The Oxford handbook of corporate law and governance*, (251) 269 (2018).
35. J. Macey, J. Mitts, *Finding order in the morass: the three real justifications for piercing the corporate veil*, Cornell law review, (99) 152 (2014).
36. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 111 (2016).

of corporate formalities). Subsequently, proof of fraud or injustice is required. This second step makes clear that in order to trigger veil piercing, more than violations against the corporate form are required, and a certain intentional element must be at hand. The latter is particularly responsible for the vagueness that is traditionally associated with the veil piercing concept. It should be noted that the US two-pronged test clearly illustrates the distinction between abuse *in* and abuse *of* companies as mentioned earlier. When shareholders violate the corporate form (the first step in the test), there is abuse *in* the company. However, the US doctrine on veil piercing requires more to lift the corporate veil. Proof of fraud or injustice must be provided to consider it abuse *of* the corporate form, and so to justify the ultimate remedy of veil piercing.

[3] Continental European Experiences

Veil piercing on grounds of disregarding of the corporate form is not limited to the US. The 'laundry list' approach to determine whether a shareholder wrongly dominated the company can also be found in other jurisdictions. For example, Belgian and French doctrine also list factors as the absence of corporate bookkeeping, the intermingling of bank accounts, payment of private expenses by the company, absence of corporate formalities, etc., as indications of abuse of legal personality that can justify veil piercing.[37] Piercing decisions are rare, however, and will only take place in extreme situations when shareholders clearly neglect to act in the interest of their company and thereby harm creditors.

Asset commingling serves as a good example. It is a predominant element in veil piercing decisions and refers to the situation where assets of the company are used by shareholders for personal use and vice versa. In many continental European countries, courts use the presence of asset commingling for justifying veil piercing. However, not every situation of asset comingling can justify a veil piercing claim. We illustrate with examples from Germany, France and Belgium.

The *German* Supreme Court, the Bundesgerichtshof (BGH), acknowledged that veil piercing ('*Durchgriffshaftung*') is an appropriate remedy when the assets of the company and the shareholder(s) are indistinguishably intermingled.[38] This is only allowed, however, in extreme circumstances when normal restitution mechanisms cannot be applied because of the complete disorganisation of the company's administration, and not for the general sanctioning of bookkeeping irregularities. Veil piercing is, for instance, only supported when the lack of transparency caused by improper accounting makes it impossible for third parties to attribute transactions to the company, and it is only applicable to the responsible shareholders who misused their

37. M. Cozian, A. Viandier, F. Deboissy, *Droit des sociétés*, Paris, Lexisnexis, 86, no 185 (2016); K. Vandekerckhove, *Piercing the corporate veil,* Kluwer Law International, 387 and 435 (2007); V. Simonart, *La personnalité morale en droit privé comparé*, 478-481, no 550 (1995).
38. BGH II ZR 178/03, Nov. 14., 2005, 2006 NZG 350.

influence.[39] Moreover, in 2007, the BGH changed its '*Durchgriffshaftung*' doctrine to the concept of '*existenzvernichtenden Eingriffs*' by stating that shareholders, when they intentionally endangered the company through unlawful behaviour, can only be held liable on a tort basis (abuse *in* the company).[40] However, the BGH explicitly pointed out that in the case of asset commingling, veil piercing based on *Durchgriffshaftung* (abuse *of* the company) remains applicable.[41]

Compared to the US, the German approach does not involve a two-pronged test. German law rather stresses the concept of subsidiarity. Intentionally defrauding creditors is not the central requirement. Veil piercing is rather seen as the *ultimum remedium* for those cases where no other remedies (general principles of law or explicit statutory provisions) are available to creditors.[42]

In *France* too, asset commingling is seen as an element that can lead to the assimilation between the shareholder(s) and the company. French doctrine interestingly uses the concept of the '*société fictive*' (fictional company), the situation where a company was founded without any '*affectio societatis*'. This is a rather ambiguous concept used to describe whether the founders truly wanted to work together in a company and undertake an economic activity.[43] However, when the company is a mere cover for a shareholder to hide, the company lacks this consent from the shareholders and is purely fictional.[44] When the only purpose of the company was to limit the creditor's recourse, the use of the company constitutes an abuse.[45] The use of a concept such as '*affectio societatis*' puts forward the intentional element, resembling the second step from the American veil piercing test (the proof of a fraud or wrong).

French legal doctrine argues that asset commingling is a different legal concept than a purely fictional company because asset commingling constitutes a wrong committed by directors that may lead to their responsibility (an abuse *in* the company).[46] However, courts frequently use both concepts without clear distinction and with the same consequences, making asset commingling a determining factor to ascertain whether the company has any real existence.[47]

In *Belgium*, it is accepted in legal literature that the corporate veil can be pierced when essential rules of company law are severely violated, especially when the

39. *Ibid.*, par. 17; T. Cheng Han, W. Jiangyu, C. Hofmann, *Piercing the corporate veil: Historical, theoretical and comparative perspectives*, NUS law working paper series 2018/025, 39, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3254130 (accessed 11 Apr. 2019).
40. BGH 16 July 2007, II ZR 3/04 (*Trihotel*).
41. *Ibid.*, par. 27; T. Cheng Han, W. Jiangyu, C. Hofmann, *Piercing the corporate veil: Historical, theoretical and comparative perspectives,* NUS law working paper series 2018/025, 41, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3254130 (accessed 11 Apr. 2019).
42. *Ibid.*
43. M. Cozian, A. Viandier, F. Deboissy, *Droit des sociétés*, 29e édition, Lexisnexis, 81, no 173 (2016).
44. M. Cozian, A. Viandier, F. Deboissy, *Droit des sociétés,* 29e édition, Lexisnexis, 82, no 175 (2016). For an example: Cass. Com. 9 June 2009, *Rev. Sociétés* 2009, 781, note N. Mathey.
45. J.-J. Daigre, ''Société fictive'', *Rép. dr. soc.*, no 18.
46. J.-J. Daigre, ''Société fictive'', *Rép. dr. soc.*, no 25.
47. I. Tchotoutian, *Vers une définition de l'affectio societatis lors de la constitution d'une société*, L.G.D.J, 202, no 336 (2011); J.-J. Daigre, *Société fictive*, Rép. dr. soc., 25-28.

company has no proper management and when the personal assets of the shareholders' and those of the company are intermingled.[48] Veil piercing is only allowed if shareholders manifestly abused the company, having no respect of its separate existence making it only a cover for the shareholders' own activities. In that respect, similarly to German law, judicial veil piercing is seen as an '*ultimum remedium*' to resolve cases where statutory rules fall short.[49] Shareholders cannot be allowed to invoke the benefits of the institution of limited liability when they have not respected the rules related to it; in that case, they can be seen to have forfeited the right to enjoy limited liability.[50] Proof of an intentional element or fraud is, however, not generally required. It should be mentioned that although veil piercing was frequently invoked and allowed in the 1970s and 1980s, recent veil piercing cases are extremely rare or even non-existent.

[B] Undercapitalisation

[1] Overview

The second category of situations that may lead to veil piercing concerns undercapitalisation. In the context of this chapter, undercapitalisation is used in a broad sense covering different situations in which shareholders have made insufficient investments in their company to let it operate properly. Undercapitalisation is potentially highly detrimental to the interests of creditors as in those cases, creditors actually bear the ultimate business and insolvency risk of the company instead of the shareholders.[51] Therefore, undercapitalisation can be qualified as one of the basic types of abuse of companies with limited liability. Similar to cases of disregarding of the corporate form *(supra)*, in many jurisdictions veil piercing serves as the ultimate sanctioning mechanism in case of this type of abusive use of limited liability companies.

Undercapitalisation can be at stake at all stages of the corporate lifecycle. Most clear is the case for denying limited liability where the undercapitalisation is the result of shareholders actively shifting assets out of their company (asset stripping). Alternatively, undercapitalisation can be present already at the time of a company's formation, in which case a company is being set-up while it is, from the onset, deemed to go bankrupt. Finally, when a company continues its operations behind the moment on which it should have been clear that insolvency was inevitable, undercapitalisation will be at stake too. However, undercapitalisation does not always lead to veil piercing as additional conditions must be fulfilled.

48. E. Dirix, R. Steennot, H. Vanhees, *Handels- en economisch recht in hoofdlijnen,* Antwerpen, Intersentia, 48 (2014); K. Geens, M. Wyckaert, *De Vennootschap - Algemeen deel* in *Beginselen van het Belgisch Privaatrecht*, Kluwer, 342 (2011).
49. K. Vandekerckhove, *Piercing the corporate veil,* Kluwer Law International, 33 (2007).
50. *Ibid.;* K. Geens, M. Wyckaert, *De Vennootschap - Algemeen deel* in *Beginselen van het Belgisch Privaatrecht*, Kluwer, 342 (2011).
51. P. Davies, *Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency,* European Business Organization Law Review, (301) 306 (2006).

Beyond disregarding of the corporate form, directors may also in some way be involved in and bear the responsibility for the undercapitalisation of their company. Moreover, several specific cases of undercapitalisation were identified by the legislators in many countries, leading to statutory rules defining shareholders' and/or directors' liability in certain cases in this respect. This clearly reduces vagueness and uncertainty compared to veil piercing in case of disregarding of the corporate form. However, it makes the picture more complex, particularly from a legal comparative perspective, as questions arise as to who can be held liable, whether separate or joint liability exists, and to which amounts.

[2] Asset Stripping

A straightforward example of undercapitalisation that can be considered abuse of the corporate form and therefore lead to veil piercing is when shareholders unlawfully take assets out of the company and leave the company 'undercapitalised' behind. This behaviour deteriorates creditors' chances of full repayment.

Asset stripping can be analysed in different ways. First of all, particularly in a US context,[52] it could be seen as a case of disregarding the corporate form rather than a case of undercapitalisation. Asset stripping will frequently coincide with commingling of assets. Shareholders use the company's assets for their own benefit, thus neglecting the separate legal personality of their company. As previously explained, 'commingling of assets' figures on the laundry list of situations that may lead to the conclusion that the corporate form is disregarded, which in its turn may lead to veil piercing (compare *supra* §8.03[A][2][ii]).

In a continental setting, asset stripping (which leaves the company undercapitalised) is mostly analysed in the context of distributions to shareholders. A good example in that respect can be found in the *Netherlands*. In multiple cases, the Dutch Supreme Court acknowledged that shareholders can be held personally liable in case of asset stripping.

Most famous is the *Nimox* case.[53] In this case, the sole shareholder of a company decided to pay out a substantive dividend. This decision was taken with respect of the Dutch statutory rules on profit distributions at that time[54] as the dividend was entirely paid out of distributable reserves. Shortly after the payment of dividend, the company went bankrupt. It had suffered losses for several years, including the year in which the distribution took place. The shareholder was held liable because it had not considered the possibility that the continuation of the company's activities could be endangered by the distribution of dividend. Importantly, the court stated that the statutory distribution rules are not the only rules that need to be taken into account when deciding on

52. *See*, e.g., S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 108 (2016); J. Macey, J. Mitts, *Finding order in the morass: the three real justifications for piercing the corporate veil,* Cornell law review, (99) 107 (2014).
53. Hoge Raad 8 Nov. 1991, *NJ,* 174.
54. *See* Art. 15 Second Directive of 13 Dec. 1976 (Capital Directive) (77/91/EEC).

dividends, but also the general duty of care. The essential element leading to shareholder liability seems to be that the shareholders are responsible for shifting excessive risks towards the company's creditors by not taking into account the possibility of a deficit or discontinuation of the company when reducing the assets of the company.[55]

It should be noted that according to Dutch jurisprudence, asset stripping leads to shareholder liability, which is distinct from real veil piercing. In the Netherlands, ''direct'' veil piercing, by which limited liability or even legal personality is being entirely set aside, is not or hardly recognised by the courts.[56] 'Direct' veil piercing can only be used as an '*ultimum remedium*'. Situations where 'direct' piercing would be appropriate are when tort claims would provide no recourse, for example in the context of groups of companies where the assets of the individual companies are completely commingled.[57] This underlines the link between undercapitalisation and disregarding of the corporate form as grounds for veil piercing. The main difference between veil piercing and shareholder liability lies in the amount of damages that can be due.[58] In the former case, the shareholder is liable for all debts of the company. In the latter case, the shareholder can only be held liable for the actual damage caused by his or her fraudulent act.[59]

The *German* BGH follows a very similar approach. Shareholders can be held liable for '*existenzvernichtenden Eingriffs*', for example in case of unauthorised distributions of the company's assets, or the misuse of corporate assets for personal purpose, or transactions with shareholders that are not at arm's length. In its 2007 *Trihotel* case, the court made clear that claims for '*existenzvernichtenden Eingriffs*' need to be handled on a tort basis (compare *supra* §8.3[A][3]).[60] Before the *Trihotel* case, the court used a different approach, called '*Durchgriffshaftung*', which is to be understood as direct veil piercing.[61] After the *Trihotel* case, the latter concept can only be invoked in a very limited number of cases not covered by the theory on '*existenzvernichtenden Eingriffs*'.[62]

55. J. Barneveld, *Financiering en vermogensonttrekking door aandeelhouders*, Deventer, Kluwer, 483 (2014).
56. Asser/Maeijer/Van Solinge & Nieuwe Weme 2-II 2009, 1068, no 836.
57. M.L. Lennarts, *Concernaansprakelijkheid,* Deventer, Kluwer, 243 (1999).
58. Hoge Raad 13 oktober 2000, *Rainbow products/ontvanger*, 698 (NJ 2000); J. Barneveld, *Financiering en vermogensonttrekking door aandeelhouders*, Deventer, Kluwer, 471 (2014).
59. J. M.M. Maeijer, comment on Hoge Raad 13 oktober 2000, (698) p. 16 (*NJ* 2000). E.g., in the case of asset stripping, the fact that certain assets were withdrawn from the company is not necessarily the cause for the bankruptcy, and correspondingly, shareholders are not necessarily responsible for the whole net loss of the company. When the asset stripping itself caused the bankruptcy, the situation is different.
60. BGH 16 July 2007, II ZR 3/04 (*Trihotel)*.
61. BGH 24 June 2002, II ZR 300/00 (*KBV)*.
62. T. Cheng Han, W. Jiangyu, C. Hofmann, *Piercing the corporate veil: Historical, theoretical and comparative perspectives,* NUS law working paper series 2018/025, 41, https://papers.ssrn.com/sol3/papers.cfm?abstract_id = 3254130 (accessed 11 Apr. 2019).

[3] Undercapitalisation upon Formation

Undercapitalisation can be present from the moment of establishment of the company, that is when it is being set-up and the founders know or should have known that the lack of financing for the planned activities would result in bankruptcy. Remarkably, only a few jurisdictions explicitly recognise this phenomenon. This is particularly the case in Belgium, where statutory rules exist with regard to the liability of founders in case of inadequate funding of a company at the time of its formation.

If a company goes bankrupt within three years of its formation, the founding shareholders can be held jointly liable when it is established that the start-up capital was manifestly insufficient for the normal operation of the business for two years consequent to its formation.[63] When it is proven that the company was undercapitalised upon formation, the founders are liable for the net loss of the company. Proof that the undercapitalisation upon formation led to bankruptcy, or proof of a fault as such are not necessary.[64] The personal liability does only apply to the founding shareholders.

When establishing a company, the founders need to draw up a financial plan. In this financial plan, the founders need to outline and determine the financial needs of their company sufficient for its operational activities during the first two years. In case of bankruptcy, the court will investigate this financial plan for determining whether the company was undercapitalised at the time of its formation if the appointed liquidator requests to. The founders can only be held liable if the total initial financing of the company was manifestly inadequate.[65]

Even if the statutory conditions are not fulfilled, for example when bankruptcy occurs later than three years after the incorporation, the majority of the Belgian doctrine accepts that common tort rules can still be invoked to hold a shareholder liable

63. Art. 229, 5° Belgian Company Code. The notion 'capital' can be misleading, since not only equity, but also other financial resources (such as shareholder loans, external credit or subsidies) must be taken into account. P. Coussement, M. Tison, *Oprichteraansprakelijkheid* in *Bestendig Handboek Vennootschap & Aansprakelijkheid*, afl. 4, 58, no 4100 (2003).
64. H. Braeckmans, R. Houben, *Handboek Vennootschapsrecht*, Antwerpen, Intersentia, 548, no 1010 (2011).
65. The original financial assessments from the financial plan are subject to a marginal appreciation by the court that must take the perspective of the time of incorporation with the information that was available at that time. The capital is considered to be manifestly insufficient when this should have been clear to every reasonable person (in this context, any reasonable founder). In principle, the fact that the insolvency was caused by external factors (e.g., insolvency of a major client or a total market collapse) is not relevant if the courts find that the company was manifestly undercapitalised. However, external factors can liberate the founders from liability when those external elements were not foreseeable at the time of incorporation. P. Coussement, M. Tison, *Oprichteraansprakelijkheid* in *Bestendig Handboek Vennootschap & Aansprakelijkheid*, afl. 4, 55, nrs. 4086 and 4108 (2003).

for the undercapitalisation upon formation of the company.[66] However, it will be much harder to hold a shareholder accountable.[67]

These explicit statutory rules concerning the adequate financing upon formation of the company contrast with other jurisdictions. However, the fact that shareholders need to provide sufficient funds is not unique. In the Netherlands, for example, it is accepted that a company must be adequately funded upon formation, and that shareholders can be held liable when undercapitalisation is apparent.[68]

[4] Undercapitalisation in Other Stages of the Corporate Lifecycle

Can undercapitalisation be at stake in other situations besides the company's formation and cases of asset stripping? Of course. At any time in the corporate lifecycle, a company can experience the absence of insufficient means which may prevent it from operating properly.

Although frequently cited in veil piercing cases,[69] US doctrine generally acknowledges that undercapitalisation is, in itself, insufficient to justify veil piercing.[70] Arguments put forward for considering undercapitalisation being insufficient are, inter alia, the fear for hindsight bias in combination with the risk of requiring too much capital as

66. H. De Wulf, *Concernaansprakelijkheid* in *Bestendig Handboek Vennootschap & Aansprakelijkheid*, afl. 3, 98 (2002); K. Vandekerckhove, *Piercing the corporate veil*, Kluwer Law International, 118 (2007).
67. Because proof is needed of (1) a fault (the undercapitalisation), (2) damage and (3) a causal link. This option is in practice, however, not so often used by the courts; K. Vandekerckhove, *Piercing the corporate veil,* Kluwer Law International, 120 (2007).
68. C. Asser, G. Van Solinge en M.P. Nieuwe Weme, Rechtspersonenrecht: NV en BV Oprichting, vermogen en aandelen, in *Mr C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk recht*, Deventer, Kluwer, 174-175 (2013); J. Barneveld, *Financiering en vermogensonttrekking door aandeelhouders*, Deventer, Kluwer, 505 (2014).
69. R.B. Thompson, *Piercing the corporate veil: an empirical study*, *76 Cornell L. Rev.,* (1036) 1065 (1991).
70. *See* for instance *Walkovszky v. Carlton,* 223 N.E.2d 6 (N.Y. 1966); S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 128 (2016); J. Macey, J. Mitts, *Finding order in the morass: the three real justifications for piercing the corporate veil,* Cornell Law Review, (99) 15 (2014). In the famous *Walkovsky v. Carlton* case, Mr Walkovsky was severely injured when he was run down by a taxicab company owned by Mr Carlton. The company had no other assets than the cab and only the minimum automobile liability insurance required by law (in the amount of USD 10,000) was carried on the cab. Mr Carlton had many of these 'cab companies' that allegedly were operated as a single entity. Mr Walkovsky requested the personal liability of the shareholders for his damages. The court held that his claim was inadequately stating a cause of action. However, Judge Keating had a dissenting opinion and stated that 'a participating shareholder of a corporation vested with a public interest, organised with capital insufficient to meet liabilities which are certain to arise in the ordinary course of the corporation's business, may be held personally responsible for such liabilities'.

a precaution.[71] Moreover, openly holding shareholders liable in all cases of undercapitalisation would completely contradict the idea of limited liability.[72]

It is generally accepted that shareholders do not have a duty to make additional investments in their companies when the company is running out of money to manage its business properly, so this cannot lead to veil piercing. On the other hand, shareholders and their agents are at any time supposed to act with an appropriate level of care. As long as the company is in going concern and is not suffering from financial difficulties, this has no direct implications with regard to creditors, except in cases of asset stripping (compare supra §8.03[B][2]). This picture completely changes, however, when a company is on the vicinity of insolvency as at that moment creditors become the ultimate risk bearers.[73] At that point, the company's agents should take the interests of the creditors into account to act according to the proper standard of care. If they do not and continue the company's operations beyond the point where it is clear that the company is deemed to go bankrupt, undercapitalisation constitutes an abuse of limited liability. Limited liability is used to gamble for resurrection or for other purposes, to the clear detriment of creditors.

Continuing a limited liability company beyond the point at which it is clear that insolvency is unavoidable can be considered a case of abusive undercapitalisation that might lead to veil piercing. Given the importance and frequency of these types of situations, most jurisdictions developed more detailed and nuanced rules in this respect, whether through statutory law or through jurisprudence.[74] Reference can be made to the UK rules on wrongful trading,[75] the German rules on the timely filing of insolvency procedures,[76] or the French *'action en comblement de passif'*.[77]

It should be noted that in developing these more specific rules, legislators and courts expressly shift liability for these situations of wrongful undercapitalisation from the shareholders to their agents, the directors. In closed corporations, however, directors and shareholders will often be the same individuals. Moreover, in most

71. S. Bainbridge, M. Todd Henderson, *Limited liability: A legal and economic analysis*, Elgar Publishing, 127 (2016).
72. D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability,* Washington & Lee public studies research paper series, Working paper 2006-08, 28, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).
73. P. Davies, *Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency,* (301) 306 *(EBOR* 2006).
74. *See* for an overview S. Kalss, N. Adensamer & J. Oelkers, *Director's duties in the vicinity of insolvency – a comparative analysis with reports from Germany, Austria, Belgium, Denmark, England, Finland, France, Italy, the Netherlands, Norway, Spain and Sweden* in M. LUTTER (ed.), *Legal Capital in Europe*, ECFR Special Volume 1, 112-143 (2006).
75. S. 214 Insolvency Act 1986.
76. § 15(a)1 Insolvenzverordnung; *see* for a comparison between the UK and the German approach T. Bachner, *Creditor protection in private companies: Anglo-German perspectives for a European legal discourse*, Cambridge, Cambridge University Press, 180-247 (2009).
77. Art. L651-2 Code de commerce. *See* in that respect, e.g., M. Cozian, A. Viandier, F. Deboissy, *Droit des sociétés,* Paris, Lexisnexis, 191, no 391 et seq. Historically, Belgium has a similar liability rule, but an additional UK-style of wrongful trading rules has been introduced recently (2018), *see* Art. XX.227 of the Belgian Code of Economic Law.

jurisdictions, liability also applies to shadow directors and de facto directors,[78] which, in many cases, will lead to a situation very similar to veil piercing. A company's dominating insider is being held personally liable for – at least a part of – the company's debts.

[C] Intermediary Conclusion

The possibility to pierce the corporate veil can be seen as an essential attribute of the concepts of legal personality and limited liability. In those cases where the essential characteristics of these concepts are being abused to the detriment of third parties, it is deemed appropriate that they can be set aside.

Veil piercing is a severe sanction which can have a positive deterring effect, but adds an important level of uncertainty to the crucial concept of limited liability too. Consequently, courts worldwide seem to be highly reluctant to conclude to veil piercing. We identified two main categories of situations in which veil piercing claims can be successful: non-observance of the corporate form, and undercapitalisation. The former referring to abuse of the entire concept of legal personality, and the latter more specifically directed to abuse of the feature of limited liability.

What became clear is that mere situations of absence of capital, undercapitalisation or lack of complying with corporate formalities never suffice to conclude to veil piercing. Additional elements are required, whether it is proof of an intention to defraud creditors, specific circumstances (insolvency) or the intentional inactivity of corporate incumbents and shareholders. According to the jurisdiction at stake, these additional elements are quite divergent, but have in common that they add a certain level of vagueness to the concept of veil piercing.

Another downside of veil piercing, besides this ambiguity of the applicable criteria, is its boldness. In its most severe version, the entire construction of legal personality is being set aside. It results in the refusal of belief in the company itself and the latter cannot longer be subjected to other statutory rules or procedures. Even if lifting the veil only leads to the denial of limited liability, instead of the rejection of legal personality as such, the results are outspoken. In cases where several shareholders with different positions or even other insiders were involved, this may be problematic.

The uncertainty, vagueness and bold character of veil piercing seem to have brought many legislators to develop statutory rules with regard to situations which are traditionally seen as abusive situations that could lead to veil piercing, particularly with regard to undercapitalisation. Moreover, in some jurisdictions also the highest courts seem to prefer to develop alternative, more nuanced theories to hold shareholders liable based on tort rather than applying veil piercing. In that respect, reference can particularly be made to the above-mentioned evolutions in Germany and the Netherlands.[79]

---

78. *See* for the difference between both concepts, e.g., A. Keay, *Company directors' responsibilities to creditors,* Abingdon, Routledge-Cavendish, 8 (2007)*;* P. Davies, *Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency*, (301) 312 *(EBOR* 2006).
79. *Supra* §8.3[B][2].

§8.04 ABUSE OF COMPANIES, VEIL PIERCING AND THE ROLE OF STATUTORY LAW

As established in the preceding paragraphs, in most jurisdictions, regarding abuse of the essential characteristics of a company, a complex but interesting combination coexists of statutory rules, jurisdictional rules on shareholder responsibility, often based on tort, and finally the jurisdictional concept of veil piercing. From a policy perspective, an important question in this respect is whether an optimal combination and equilibrium between these different approaches can be developed.

The approach based on *statutory rules* has the advantage to provide more legal certainty. It makes the work of courts and liquidators easier, and it allows nuance and specification. Particularly, it allows allocating liability more adequately. Examples illustrating this approach relate, *i.a.*, to asset stripping. Almost all jurisdictions have rules on profit distributions[80] and accompanying liability rules for both directors and shareholders.[81] The same applies to undercapitalisation in the vicinity of insolvency, a situation that legislators worldwide have scrutinised, whether it be through rules on wrongful trading targeted at directors and shadow directors, whether through insolvency filing duties, or whether through US-style fraudulent transfer rules.[82] Also, many situations that are traditionally associated with non-observance of the corporate form are targeted by statutory rules. Many jurisdictions have express provisions on – sometimes even criminal – liability for neglecting the rules on corporate bookkeeping or the improper use of corporate assets.[83]

The appropriateness of the latter statutory rules leading to the conclusion of non-observance of the corporate form for solving all specific situations can be questioned.[84] There is room for the proper role of veil piercing doctrine. In some cases, the application of the statutory rules will not lead to a useful result, for instance, because the director who is being held liable is insolvent or because it is hard to proof the causal link between the unlawful behaviour and the injury of the creditors. In those situations, veil piercing is a helpful instrument. When a creditor or liquidator can prove that the essential features of the company are being abused in order to defraud creditors, irrespective of whether (other) statutory rules are being respected, courts should be able to pierce the corporate veil and thus to set aside the entire legal fiction of limited liability and/or legal personality. However, veil piercing should remain an extraordinary measure for extraordinary circumstances and only serve as an ultimate backstop.

Statutory rules on abusive practices and veil piercing doctrine can and should coexist. The better those statutory rules are designed and applied in a certain

80. Whether it be balance sheet test or solvency test-based rules or a combination of both; *see*, e.g., W. Schön, *Balance sheet tests or solvency tests – or both?,* 181-198 *(EBOR* 2006).
81. *See*, e.g., Art. 2:216 par. 3 of the Dutch Civil Code or Art. 263 of the Belgian Companies Code.
82. *See* in this respect, e.g., § 548 of the US Bankruptcy Code.
83. *See*, e.g., the French rules concerning *L'abus de biens sociaux* (art. L241-3 Code de commerce).
84. *See*, e.g., D. Millon, *Piercing the corporate veil, Financial responsibility, and the limits of limited liability*, Washington & Lee public studies research paper series, Working paper 2006-08, 3, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=932959 (accessed 11 Apr. 2019).

jurisdiction, the less important the doctrine on veil piercing will become, and the more certainty can be provided. In its current setting, it seems that many uncertainties remain in the different countries where veil piercing is found in case law. First, a variety of persons responsible for the shortcomings in the company's performance leading to the question to pierce the corporate veil can be found: the parent company, the controlling shareholder(s), director(s) or shadow director(s). Second, there is a dichotomy as to when piercing the corporate veil can be introduced as a plea: in cases of insolvency or even outside the scope of formal insolvency proceedings. It results in different parties that can file a case for veil piercing. Third and not least, the reasons for applying the lifting of the corporate veil are different: they range from general misconduct over specific actions, such as asset commingling, to even faultless liability. The latter often affects the size of the claim that can be initiated.

Statutory rules can further reduce these uncertainties. At the European level, two relatively novel approaches deserve to be studied as to their effectiveness. First, the Alternative Investment Fund Directive provides limitations of asset stripping.[85] When an alternative investment fund acquires control over a non-listed company, the latter company is, for a period of two years, not allowed to make any distribution, capital reduction, share redemption or acquisition of own shares when it would adversely affect the financial condition of the company[86]. The alternative investment fund is not allowed to vote for any kind of asset stripping that the governing body of the company lists as an item on the agenda at the general meeting, and the fund must even use its best efforts to prevent any kind of asset stripping. The latter rules add objective elements[87] as to what can trigger the liability of a controlling shareholder. Second, according to the proposal for a directive on cross-border conversions, mergers and divisions, Member States' supervisory agencies must prevent that 'artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members' can take place.[88] This approach brings in an *ex ante* assessment which could help preventing that *ex post* court assessments leading to veil piercing would take place.[89]

Alternatively, the question can be raised to what extent there is room for *other related doctrines* to protect creditors from certain abusive practices developed by the courts based on general principles of law. This is particularly the case for the German and Dutch jurisprudence on asset stripping based on tort law. Another important

85. Art. 30 of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, *Pb. L* 175, 1 July 2011 (hereinafter the AIFM Directive).
86. The conditions can be found in Art. 30, §§ 2 and 3 of the AIFM Directive.
87. It should be noted that according to the AIFM Directive, the alternative investment fund can still withhold its votes and consequently, the resolution can be passed. We would support the statutory rule that the controlling shareholder must vote against this resolution. However, the alternative investment fund must show how it tried to prevent any kind of asset stripping.
88. Art. 86 c and 86 k of the proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, 25 Apr. 2018, SWD(2018) 141 final.
89. Critically, however, Karsten Engsig Sørensen in Chapter 12 of this book.

example in that respect is the jurisprudence that exists in some countries regarding the subordination of shareholder loans,[90] which could be considered a sort of shareholder liability in case of undercapitalisation. Particularly in a European continental setting, we are rather critical as to the desirability of the latter type of concepts on shareholder liability developed by the courts, besides the doctrine of veil piercing. Where the essential characteristics of a company are being abused to the detriment of creditors, and statutory rules cannot lead to a desirable outcome, veil piercing seems to be the appropriate answer. Other doctrines developed by the courts create more uncertainty and threaten to undermine the idea of limited liability.[91]

§8.05 CONCLUSION

Our analysis shows that most legal systems acknowledge that the corporate form can be abused. The corporate form not only brings great prosperity but it can also, in rather exceptional circumstances, be helpful to defraud other parties involved in corporate life. However, making a distinction between an appropriate and an inappropriate use of the corporate form is particularly difficult and therefore requires very careful investigation and consideration in order to avoid that the major benefits of establishing a company are forfeited. Consequently, many countries have a specific, most of the time, *ex post* judicial approach for veil piercing and some sort of liability rules for shareholders. However, legislators also try to play an important role in reducing the uncertainty that is being caused by the concept of veil piercing. An illustration of a legislative *ex ante* measure is the requirement for establishing a financial plan upon formation of the company in which the founders must determine the financial needs of their company sufficient for its operational activities. Despite all the measures, uncertainty remains as to when abuse of the corporate form exists, as well as the questions how to prevent and to remedy the abusive use of the corporate form.

One measure which we suggest to further limit the likelihood of the abusive use of the corporate form is the generalisation of the limitation for alternative investment fund managers supporting a distribution of a company's assets in the aftermath of a take-over. Similarly, supervisory agencies should be given a chance to contribute to the prevention of the abusive use of the corporate form by raising questions in circumstances of cross-border conversions, mergers and divisions of companies. These statutory rules can help in reducing the uncertainty surrounding the application of veil piercing, but we acknowledge that the role of the courts in assessing the behaviour of corporate incumbents justifying veil piercing will remain pivotal.

90. *See* in this respect, e.g., A. Cahn, *Equitable subordination of shareholder loans?* 287-300 *(EBOR* 2006).
91. Like it has been the case in the Netherlands where the Nimox jurisprudence (cf. *supra)* served as one of the arguments to completely reform the (liability) rules on profit distributions for closed companies; *Kamerstukken II* 2006/07, 31058, no 3, p. 33.